

CPP ANNUAL USE OF CAPITAL SURVEY - 2010



NAME OF INSTITUTION

(Include Holding Company Where Applicable)

Citizens South Bank (Holding Company: Citizens South Banking Corporation, Gastonia, NC)

Point of Contact:	Kim S. Price, President and CEO, Citizens South Bank	RSSD: (For Bank Holding Companies)	397175
UST Sequence Number:	195	Docket Number: (For Thrift Holding Companies)	H-3027
CPP/CDCI Funds Received:	20,500,000	FDIC Certificate Number: (For Depository Institutions)	28833
CPP/CDCI Funds Repaid to Date:		Credit Union Charter Number: (For Credit Unions)	N/A
Date Funded (first funding):	December 12, 2008	City:	Gastonia,
Date Repaid ¹ :	N/A	State:	North Carolina

¹If repayment was incremental, please enter the most recent repayment date.

American taxpayers are quite interested in knowing how banks have used the money that Treasury has invested under the Capital Purchase Program (CPP) and Community Development Capital Initiative (CDCI). To answer that question, Treasury is seeking responses that describe generally how the CPP/CDCI investment has affected the operation of your business. We understand that once received, the cash associated with TARP funding is indistinguishable from other cash sources, unless the funds were segregated, and therefore it may not be feasible to identify precisely how the CPP/CDCI investment was deployed or how many CPP/CDCI dollars were allocated to each use. Nevertheless, we ask you to provide as much information as you can about how you have used the capital Treasury has provided, and how your uses of that capital have changed over time. Treasury will be pairing this survey with a summary of certain balance sheet and other financial data from your institution's regulatory filings, so to the extent you find it helpful to do so, please feel free to refer to your institution's quarterly call reports to illustrate your answers. This is your opportunity to speak to the taxpayers in your own words, which will be posted on our website.

What specific ways did your institution utilize CPP/CDCI capital? Check all that apply and elaborate as appropriate, especially if the uses have shifted over time. Your responses should reflect actions taken over the past year (or for the portion of the year in which CPP/CDCI funds were outstanding).

☒ **Increase lending or reduce lending less than otherwise would have occurred.**

The institution continues to make small business loans, full documentation residential mortgage loans, and multifamily mortgage loans, the institution has expanded its lending area to North Georgia through two FDIC-assisted acquisitions on March 19, 2010, and April 15, 2011.

☒ **To the extent the funds supported increased lending, please describe the major type of loans, if possible (residential mortgage loans, commercial mortgage loans, small business loans, etc.).**

Residential mortgage loans with subsidized interest rates for individual purchasers of potential OREO properties and unsold speculative homes on which the Bank held a lien and new small business loans are the major types of loans supported by the CPP capital infusion. (See page 3 below).

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☐ Increase securities purchased (ABS, MBS, etc.).

☐ Make other investments.

☒ Increase reserves for non-performing assets.

Reserves for were increased from \$7.3 million at November 30, 2008, to \$12.5 million at April 30, 2011 (net of charge offs and write-downs). During this same period, net loans increased from \$620.7 million at November 30, 2008, to \$752.8 million at April 30, 2011.

☒ Reduce borrowings.

Borrowed money was decreased from \$149.5 million at November 30, 2008, to \$107.9 million at April 30, 2011. During this same period, assets increased from \$818.7 million at November 30, 2008, to \$1.1 billion at April 30, 2011.

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☐ Increase charge-offs.

☒ Purchase another financial institution or purchase assets from another financial institution.

On March 19, 2010, Citizens South Bank acquired Bank of Hiawassee, with branches in Towns, Union, and Fannin Counties, Georgia, with FDIC assistance. On April 15, 2011, Citizens South Bank acquired New Horizons Bank in East Ellijay (Gilmer County), Georgia, both with FDIC assistance.

☐ Held as non-leveraged increase to total capital.

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What actions were you able to avoid because of the capital infusion of CPP/CDCI funds?

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What actions were you able to take that you may not have taken without the capital infusion of CPP/CDCI funds?

Without the infusion of capital from CPP funds, Citizens South Bank would not have been able to take the actions necessary to increase in size in order to serve its customers better, expanding from a 15-branch bank with \$819 million in assets, including \$621 million in net loans, on November 30, 2008, to a 21-branch bank with \$1.12 billion in assets, including \$753 million in net loans, on April 30, 2011. Immediately after the receipt of CPP funds on December 12, 2008, the parent holding company used \$15,000,000.00 in December 2008 as a Tier 1 capital contribution to the subsidiary bank, Citizens South Bank, from the parent holding company, Citizens South Banking Corporation. From 2009 to 2011, full-service bank branches were added in Mecklenburg County, North Carolina, as well as Towns, Union, Fannin, and Gilmer Counties, Georgia. The CPP Mortgage Loan Program and the CPP Small Business Loan Program could not have been implemented in 2009 and 2010 without the CPP capital. The Citizens South Bank CPP Mortgage Loan Program was developed in 2009 as a way to invest this capital in housing in Citizens South Bank's local communities. The CPP Mortgage Loan Program was developed by Citizens South Bank's President and CEO, Kim S. Price, in early February 2009, as an innovative program to use the CPP funds for mortgage loans in its local markets, and the first loan under this new program was made on February 26, 2009. Through April 30, 2011, there have been 43 mortgage loans made under that program, for a total of \$11,948,435, representing 58.3% of the entire infusion of CPP funds. Several of the loans have been loans to facilitate the sale of foreclosed residential real estate owned properties. Several of the loans have resulted in avoiding delinquency and/or foreclosure or eliminated the need for foreclosure of some speculative construction properties, which have been sold to retail consumers using the CPP program funds. Next, the CPP Small Business Loan Program was developed in early January 2010, as an innovative program to use the CPP funds for small business loans in its local markets, and the first loan under that program was made on January 22, 2010. Through April 30, 2011, there have been nine small business loans made under that program for a total of \$4,734,240. This record indicates an innovative, yet prudent, use of a significant portion of the CPP funds which has resulted in the promotion of home ownership and economic revitalization within the Bank's market areas in three states. From December 1, 2008, through April 30, 2011, the bank has originated or renewed in excess of \$400 million in loans. In addition, the CPP funds have improved the Bank's capital ratios by the investment of \$15,000,000 as equity capital directly into the subsidiary, Citizens South Bank. In order to preserve capital, the quarterly cash dividend paid to common stockholders of Citizens South Banking Corporation has been reduced 88% from 8.5 cents in 2008 to one cent per common share, effective November 1, 2010. In addition, the company suspended the repurchase of common stock in 2008 until the obligation for the CPP capital has been satisfied.

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Please describe any other actions that you were able to undertake with the capital infusion of CPP/CDCI funds.

With the capital infusion of CPP funds, Citizens South Bank, effective April 15, 2011, was able to acquire substantially all of the assets and assume substantially all of the liabilities of New Horizons Bank, a Georgia state-chartered bank headquartered in East Ellijay, Georgia, from the Federal Deposit Insurance Corporation (the "FDIC"), as receiver for New Horizons Bank, pursuant to the terms of a purchase and assumption agreement entered into by Citizens South Bank and the FDIC. In this action, Citizens South Bank acquired \$107.6 million in assets, including \$76.1 million in loans, assumed \$106 million in liabilities, including \$101.9 million in deposits of New Horizons Bank, and acquired one banking office. No additional capital was needed in order to complete this transaction. Citizens South Bank paid the FDIC a premium of approximately 1% for the right to assume the deposits of New Horizons Bank. In connection with this transaction, Citizens South Bank entered into loss-sharing arrangements with the FDIC that covered approximately \$84.6 million of the former New Horizons Bank's assets. Citizens South Bank will share in the losses on the asset pools (including residential properties and nonresidential properties) covered under the loss-sharing arrangements. Pursuant to the terms of the loss sharing arrangements, the FDIC is obligated to reimburse the Bank for 80% of eligible losses with respect to all covered assets. The Bank has a corresponding obligation to reimburse the FDIC for 80% of eligible recoveries with respect to covered assets. In a similar transaction, effective March 19, 2010, Citizens South Bank, also acquired substantially all of the assets and assumed substantially all of the liabilities of Bank of Hiawassee, a Georgia state-chartered bank headquartered in Hiawassee, Georgia, from the FDIC, as receiver for Bank of Hiawassee. This acquisition included all five banking offices of Bank of Hiawassee. In this action, Citizens South Bank acquired \$300 million in assets, including \$227 million in loans, and assumed \$324 million in liabilities, including \$295 million in deposits of Bank of Hiawassee. Additional capital of \$15 million, through direct sales to investors in a private placement on March 17, 2010, was needed in order to complete this transaction. Citizens South Bank paid the FDIC a premium of approximately 1% for the right to assume all of the deposits of Bank of Hiawassee. In connection with this acquisition, Citizens South Bank entered into loss-sharing arrangements with the FDIC that covered approximately \$232.6 million of the former Bank of Hiawassee's assets, including single family residential mortgage loans, other loans, and foreclosed loan collateral, covered under the loss-sharing arrangements. Pursuant to the terms of the loss sharing arrangements, the FDIC is obligated to reimburse the Bank for 80% of eligible losses of up to \$102 million with respect to covered assets. The FDIC will reimburse the Bank for 95% of eligible losses in excess of \$102 million. Citizens South Bank has a corresponding obligation to reimburse the FDIC for 80% or 95%, as applicable, of eligible recoveries with respect to covered assets.